

Frequently Asked Questions Concerning IRC Conformity for 2004

1. Has Arizona conformed to the federal bonus depreciation allowed under the internal revenue code?

No. When computing Arizona taxable income, ARS § 43-1021.27 requires an add-back of the depreciation claimed on the federal return and allows a subtraction under ARS § 43-1022.28 for depreciation allowable under the internal revenue code computed as if the taxpayer had not elected bonus depreciation.

2. If a taxpayer has depreciation expense on Schedule A (itemized deductions) is the taxpayer required to add back that amount?

No. The adjustments in ARS §§ 43-1021.27 and 43-1022.28 apply only to depreciation expense included in Arizona gross income (federal adjusted gross income).

3. If a taxpayer has already filed a 2003 tax return that does not conform to these changes must an amended return be filed?

An amended return must be filed to reflect these changes if it makes a difference in Arizona taxable income.

4. Does ARS § 43-1022.29 allow a subtraction to reduce the gain to reflect the difference in basis of property for which bonus depreciation has been claimed at the time the asset is sold?

Yes. ARS § 43-1022.29 allows a subtraction in the year of the sale to claim the additional depreciation allowable under the internal revenue code for prior years if the taxpayer had not previously taken that subtraction.

5. Does the retroactive amendment of ARS § 43-1022.29 allow a subtraction to reduce the gain to reflect the difference in basis of property for which bonus depreciation has been claimed if the property has been sold in prior years?

Yes. The adjustment for the basis difference in case of disposition is to be handled in one of two ways at the election of the taxpayer:

1) Recognize the entire cumulative effect of the basis differences in case of disposition on the tax return for the first tax year ending on or after December 31, 2003 (The 2003 return). To qualify for this election, all returns prepared pursuant to the prior law must be filed by the due dates for those returns, including extensions, or April 15, 2004, whichever is later.

– or –

2) Amend each of the affected returns individually.

6. Does Arizona allow a retroactive adjustment to reflect the change in depreciation allowable for luxury autos?

Yes. The retroactive recognition of the change in depreciation methods is to be handled in one of two ways at the election of the taxpayer:

1) Recognize the entire cumulative effect of the retroactive change of depreciation

methods on the tax return for the first tax year ending on or after December 31, 2003 (The 2003 return). To qualify for this election, all returns prepared pursuant to the prior law must be filed by the due dates for those returns, including extensions, or April 15, 2004, whichever is later.

– or –

2) Amend each of the affected returns individually.

7. If a taxpayer has already filed a 2003 tax return and wants to elect to recognize the cumulative effect of retroactive changes can an amended return be filed?

Yes. An amended 2003 tax return can be filed. The cumulative adjustment can only be claimed on the 2003 tax return.

8. Does the amount of federal depreciation that is required to be added back include Sec. 179 expenses deducted on the federal return?

No. Only actual depreciation expense claimed on the federal return is required to be added back. If depreciation is claimed on a property, a portion of which has been expensed under Sec. 179, the depreciation on that portion of the property that was not expensed is required to be added back.

9. Has Arizona conformed to the federal deduction of Sec. 179 expense allowed by the Jobs and Growth Tax Relief Reconciliation Act?

No. Arizona requires the amount of Sec. 179 expense deducted on the federal return in excess of \$25,000 to be added back under ARS § 43-1021.28 and allows the amount added back to be subtracted in equal installments over a five year period under ARS § 43-1022.30.

10. If Sec. 179 property is sold before the taxpayer has subtracted all five installments of the amount in excess of \$25,000 that was added back, can the taxpayer continue to subtract those installments?

Yes. The statute provides for the subtraction over five years and makes no provision to accelerate or disallow the subtractions if the property is sold.

11. Can a taxpayer with 3 year property choose not to claim any Sec. 179 expense for Arizona purposes and take the regular depreciation expense on that property?

No. There is no provision for reporting Sec. 179 expense in a manner other than provided in ARS §§ 43-1021.28 and 43-1022.30.

12. Are S-corporations or their shareholders required to make an adjustment to add back the bonus depreciation allowed by the internal revenue code?

No. Neither S-corporations nor their shareholders required to make an adjustment to add back the bonus depreciation allowed by the internal revenue code.

S-corporations are taxable in Arizona only to the extent they are subject to federal tax. They are not subject to the additions and subtractions under ARS §§ 43-1121 & 43-1122.

The bonus depreciation deduction does not retain its character when it is passed through to the shareholder as part of distributive share income. Therefore, the shareholders would not be required to make an addition under ARS § 43-1021.30.

13. Are S-corporations or their shareholders required to make an adjustment to add back the Sec. 179 expense allowed by the Jobs and Growth Tax Relief Reconciliation Act that is in excess of \$25,000?

S-corporations are not required to add back Sec. 179 expense in excess of \$25,000; they are taxable in Arizona only to the extent they are subject to federal tax. They are not subject to the additions and subtractions under ARS §§ 43-1121 & 43-1122.

S-corporation shareholders are required to add back Sec. 179 expense in excess of \$25,000. The Sec. 179 expense does retain its character when it is passed through to the shareholder. Therefore, the shareholders would be required to make adjustments under ARS §§ 43-1021.28 and 43-1022.30 to reflect the Arizona allowance of the Sec. 179 expense.

14. Is a an out-of-state partnership with no activity in Arizona or its Arizona resident partners required to make an adjustment to add back the bonus depreciation allowed under the internal revenue code?

No. The partnership does not have Arizona gross income and is not required to file an Arizona return and therefore, is not subject to the additions and subtractions under ARS §§ 43-1021 & 43-1022. The bonus depreciation deduction does not retain its character when it is passed through to the partner as part of distributive share income. Therefore, the Arizona resident partners would not be required to make an addition under ARS § 43-1021.30.

15. Is an out-of-state partnership with no activity in Arizona or its Arizona resident partners required to make an adjustment to add back the Sec. 179 expense allowed by the Jobs and Growth Tax Relief Reconciliation Act that is in excess of \$25,000?

The partnership does not have Arizona gross income and is not required to file an Arizona return and therefore, is not subject to the additions and subtractions under ARS §§ 43-1021 & 43-1022. The Sec. 179 expense passed through to the Arizona partners does retain its character when it is passed through to the partner. Therefore, the Arizona resident partners would be required to include that Sec. 179 expense when making adjustments under ARS §§ 43-1021.28 and 43-1022.30 to reflect the Arizona allowance of the Sec. 179 expense.

16. Does Arizona recognize changes to the federal law under the Military Family Tax Relief Act of 2003 and allow amended Arizona return to exclude that gain?

The statute of limitations is suspended to allow taxpayers to claim refunds resulting from retroactive conformity to the provisions of the Military Family Tax Relief Act of 2003. A taxpayer that was able to file an amended federal income tax return to exclude the gain on the sale of a home because of changes to federal law under the Military Family Tax Relief Act of 2003, may also file an amended Arizona return to exclude that gain. If the amended return is for taxable years 1997, 1998 or 1999, you have until November 10, 2004 to file that return. When filing an amended return under this provision, write "Military Family Tax Relief Act" in red at the top of Form 140X.